

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

**COMMENTS ON NOTICE OF INQUIRY  
BY VERMONT PUBLIC SERVICE BOARD  
AND MAINE PUBLIC UTILITIES COMMISSION**

To: The Commission

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**COMMENTS ON NOTICE OF INQUIRY**

**I. INTRODUCTION AND SUMMARY**

The Vermont Public Service Board (“VtPSB”) and the Maine Public Utilities Commission (“MePUC”) (together, Vermont/Maine) submit these initial comments in response to the Commission’s Notice of Inquiry issued on April 8, 2009.<sup>1</sup> Vermont/Maine appreciate the Commission’s renewed vigor in responding to the *Qwest II* remand.<sup>2</sup> Congress required the Commission to provide support to achieve reasonably comparable urban and rural rates over ten years ago, and the Commission has not provided sufficient support to achieve Congress’ universal service objectives. The Commission should move forward quickly to address the Court remand.

As a first step, the Commission should recraft its definitions and support mechanism in a manner that advances reasonable comparability but does not make the Universal Service Fund (“Fund”) so large that it is not sustainable. Vermont/Maine recommend that the Commission adopt their updated<sup>3</sup> proposal as the best means of providing support consistent with *Qwest II*. This proposal (the “Vt/Me Proposal”), which is described in detail herein, provides sufficient

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<sup>1</sup> *In the Matter of High Cost Universal Service Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Inquiry, FCC 09-28 (rel. April 8, 2009) (“NOI”).

<sup>2</sup> *Qwest Communications Int’l v. FCC*, 398 F. 3d 1222 (10th Cir. 2005) (“*Qwest II*”); *see also Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2003) (“*Qwest I*”).

<sup>3</sup> Vermont/Maine update their proposal in these comments by substituting “Adjusted Model-Based Cost” for “Net Subscriber Cost.”

support for reasonably comparable rates by lowering the comparability percentage and using average urban cost as the basis for comparison (rather than nationwide average cost). By maintaining statewide averaging and determining carriers' support needs based on their net costs, the Vt/Me Proposal ensures that the Fund is not excessive in size.

The Commission should coordinate related initiatives, including encouraging broadband deployment and remedying serious deficiencies in its cost model, as very high priorities. The Commission can use the Universal Service Joint Board to expedite matters. Even if the comparability percentage is set at an appropriate level, carriers will not receive sufficient support if the cost model does not generate reasonably accurate forward-looking cost. The Commission's work responding to the Court will be incomplete without taking this important additional step.

The Commission should compare urban and rural costs, adjusted as described in these comments, when determining whether carriers' rates are reasonably comparable. The only way to account meaningfully for rate differences among states is to adopt cost as a proxy for rates under Section 254. The Commission can address the Court's comparability concerns by thoroughly explaining why it is impossible to use simplistic rate comparisons, and by developing an evidentiary record demonstrating that the use of robust forward-looking costs as an evaluative tool is necessary to achieve the rate comparability requirements of the statute.

The Commission should revise its definitions of "reasonable comparability" and "sufficiency" consistent with *Qwest II*. The Commission should adopt the following definitions:

Rates are reasonably comparable when rural rates, on a statewide average basis, are [no greater than 125%]<sup>4</sup> over urban rates.

The Universal Service Fund is sufficient if it provides enough support, through all the universal service programs funded under Section 254 mechanisms, to ensure that the support-related principles set forth in Section 254(b) are preserved and advanced.

With these changes, the Commission's non-rural High Cost Program will satisfy *Qwest II*.

## **II. THE COMMISSION SHOULD CONTINUE TO USE A COST-BASED USE MECHANISM WITH STATEWIDE AVERAGING BUT LOWER THE BENCHMARK**

### **A. The Commission Should Respond to the Remand Immediately, and Should also Expedite Related Cost Model Reform and Broadband Initiatives**

The Commission's highest priority in this proceeding must be to respond directly to the *Qwest II* Court order. As its first step, the Commission must recraft its support mechanism expeditiously to satisfy *Qwest II*'s requirement that the mechanism both preserve and advance universal service and narrow existing rural/urban rate gaps.<sup>5</sup> The Commission needs to: (1) lower the comparability percentage, (2) make its rural rate comparison to urban (not nationwide average) costs, and (3) use Adjusted Model-Based Cost to determine carriers' need for support. Vermont/Maine have been receiving insufficient federal support for their non-rural carrier for at least ten years, since the Commission adopted the non-rural mechanism (and thirteen years since passage of the Act). DSL and broadband deployment in their non-rural carrier's service area is significantly behind that of local "rural" carriers. This is due, at least in part, to the insufficiency of support. Recrafting the mechanism to provide sufficient support must take the highest priority.

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<sup>4</sup> Vermont/Maine recommend that the Commission set a benchmark between 115% and 125% to achieve reasonable comparability. They do not yet have a specific numerical recommendation.

<sup>5</sup> See NOI, par. 21; *Qwest II*, 398 F. 3d. at 1235-7.

The Commission should engage in other coordinated efforts to make sure that it fully meets all Section 254(b) principles. The Commission needs to address several material flaws in its cost model as a second very high priority.<sup>6</sup> Indeed, even if the benchmark is set at an appropriate level, carriers will not receive sufficient support if the cost model does not generate reasonably accurate cost figures. The Commission's work responding to the Court will be incomplete without taking this important additional step. Because model revisions are integrally linked to the provision of adequate support, the Commission should seek to have the adjustments to the model completed by the time it completes its revised rule responding to the Court's mandate.

Additionally, Vermont/Maine agree that encouraging broadband deployment is also an important goal. The Commission already has a broadband initiative underway, but needs to determine whether it will support broadband deployment through the universal service program.<sup>7</sup>

The Commission should take advantage of the Universal Service Joint Board to expedite consideration of these issues without slowing down its response to the *Qwest II* remand.<sup>8</sup> The Joint Board should identify material flaws in the model that need to be fixed for the mechanism to provide sufficient support. It should also update its recommendations on a Broadband Fund in light of the Stimulus Bill and the Commission's broadband initiative.<sup>9</sup> The Commission should

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<sup>6</sup> See NOI, par. 24.

<sup>7</sup> *Id.*, par. 28.

<sup>8</sup> In suggesting that the Commission utilize the Joint Board's expertise, Vermont/Maine are not recommending that the Commission slow down in any way revising the comparability percentage and cost mechanism or correcting the model, particularly for deficiencies that are easier to remedy like line counts. Any referral to the Joint Board should have a quick turnaround.

<sup>9</sup> See *In the Matter of High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Recommended Decision, FCC 07J-4 (November 2007); *In the Matter of a National Broadband Plan for Our Future*, GN Docket No. 09-51, Notice of Inquiry, FCC 09-31 (April 8, 2009).

either refer specific issues to the Joint Board on an expedited basis, or encourage the Joint Board to submit comments for the record.<sup>10</sup>

**B. The Commission Should Lower its Comparability Percentage, Compare Rural to Urban Costs and Use Carriers' "Adjusted Model-Based Cost" To Determine Support Needs**

The Commission must adopt a lower numerical standard for reasonable comparability than the standard used in the last two proceedings so that it can narrow existing rate disparities between rural and urban areas.<sup>11</sup> Vermont/Maine had previously recommended a comparability percentage of no more than 125% of nationwide urban rates. That standard would achieve reasonable comparability consistent with the Tenth Circuit Court's guidance in *Qwest II*. Vermont/Maine continue to recommend that the Commission's comparability percentage fall within this range and be set so that the cost disparity between urban and rural rates is less than 125%.

The Tenth Circuit has repeatedly applied numerical tests to assess whether rates were reasonably comparable. In *Qwest I*, the Court expressed doubt that a 70-80% discrepancy between some rural and urban rates would fall within a reasonably comparable range, and also criticized the Commission for failing to adopt a standard that illuminated whether this was permissible.<sup>12</sup> In *Qwest II*, the Court rejected the Commission's prior comparability standard (equivalent to 135% - 138% of nationwide average rates) because it did not narrow existing rate differences.<sup>13</sup> Additionally, the *Qwest II* Court analyzed whether the Commission's permitted

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<sup>10</sup> See NOI, par. 25 (seeking comment on efficient, timely, and cost effective processes for updating the cost model).

<sup>11</sup> See NOI, par. 21

<sup>12</sup> See *Qwest I*, 258 F.3d at 1201.

<sup>13</sup> See *Qwest II*, 398 F.3d at 1236-1237. In the *Ninth Report and Order*, the Commission adopted a reasonable comparability standard of 135% over nationwide urban rates. See *In the Matter of Federal-State Joint Board on Universal Service*, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd. 20,432 (1999) par. 10 ("*Ninth Report and Order*"). Later, in the *First Remand Order*, the FCC adopted an equivalent standard, "two standard deviations over nationwide urban rates," that would largely replicate its prior support levels. See *In the Matter of Federal State Joint Board on Universal Service, Order on Remand, Further Notice of Proposed*



rate range was reasonably comparable, based on its own practical interpretation of price differences. Judge Kelly asked rhetorically at oral argument, whether the prices for a suit would be reasonably comparable if the price was \$1x at one store and \$2x at another store. The lesson from this line of discourse is that the definition of “reasonably comparable” is, or could be, “almost the same.”

The Commission should now act consistent with its duty to advance universal service and adopt a comparability percentage that actually seeks to achieve reasonable comparability. The Court directed the Commission to use a lower measure that would “narrow the existing gap” between rural and urban rates and “abate[]” the significant variance between urban and rural rates.<sup>14</sup> *Narrowing* and *abating* the gap requires a much more aggressive benchmark.

Based on this analysis, the Commission should select a standard for reasonable comparability that is no higher than 125% of average urban rates (Adjusted Model-Based Cost). For example, using a 125% comparability standard, if the average urban rate (Adjusted Model-Based Cost) is \$20.00, then no rural customer would have a rate, (Adjusted Model-Based Cost) after Federal support, greater than \$25.00. 115% of nationwide average cost has historically been used as the threshold for support for the loop costs of rural carriers. Both 115% and 125% would produce rates that are *reasonably* comparable, in a practical sense, while not *exactly* comparable. Even with a 125% standard, rates in some rural areas may still not be reasonably comparable to those in urban areas. A state with costs 125% higher than the urban average may exceed that cost in many urban areas by much more due to the variation. With a standard no higher than 125%, the Commission will narrow and abate existing gaps in rural and urban rates

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Rulemaking and Memorandum Opinion and Order, 18 FCC Rcd. 22,559 (2003), par. 1 (“*First Remand Order*”) As the Court noted, the revised standard deviation-based benchmark equated to 138% of the nationwide average rate based on 2002 rate data. See *Qwest II* at 1236.

<sup>14</sup> *Id.* at 1236.

(Adjusted Model-Based Cost). Any standard above 125% will not meet the test for reasonable comparability.

The comparability analysis should be applied to average urban cost, and not to nationwide average cost. In order to determine average urban cost for the purpose of achieving comparability between costs (as a proxy for rates), the Commission should identify those wire centers that are “urban.” The Commission could define “average urban” as all UNI-Zone 1 wire centers and then run the cost model for all of those wire centers. The resulting weighted average forward-looking urban UNI-Zone 1 costs will become “average urban cost” for purposes of the analysis. The Commission should determine carriers’ need for support using their Adjusted Model-Based Cost. Carriers’ forward-looking cost should be reduced by amounts related to non-supported services.<sup>15</sup>

The Commission should use the same comparability percentage in its reasonable comparability definition as it does in its cost mechanism. The Commission should define reasonable comparable as follows:

Rates are reasonably comparable when rural rates, on a statewide average basis, are [no greater than 125%]<sup>16</sup> over urban rates.

The numerical comparability standard must be used consistently so that the mechanism and the definition tie together.

**C. The Commission Should Continue to Determine “Rural” Cost Based on Statewide Averaging**

The Commission should determine the need for support where statewide average cost exceeds urban cost by the comparability percentage. It should reaffirm its conception of state and federal roles in providing universal service support, and should not replace implicit state

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<sup>15</sup> See III(A), *infra*.

<sup>16</sup> Vermont/Maine recommend that the Commission set a standard between 115% and 125% to achieve reasonable comparability. They do not yet have a specific numerical recommendation.

support with federal support.<sup>17</sup> Continuing this policy will minimize the need for federal support.

Depending on local policy preferences, states can use different tools to achieve rate comparability within their borders. These tools include rate averaging, cost pooling, and state universal service funds.<sup>18</sup> Regardless of the particular tool used, the effect is the same: all ratepayers pay the same rates within the state based upon the average costs within that state. However, state programs are not suited to reducing average rates or average costs. Only the Commission can reduce high average state costs, where they exist.

For these reasons, the Commission should continue to make a clear division of labor between its own programs and those of the states. States should be primarily responsible for rate and cost differences within their own borders. The Commission should complement this activity by assuming primary responsibility to make rates lower in those states that cannot, through their own efforts, otherwise achieve reasonably comparable rates.

This recommendation is consistent with existing Commission policy for non-rural carriers. Statewide averaging correctly achieves the Commission's half of the dual federal and state role in supporting universal service. This is based upon the perception that it is the states that:

Have the primary responsibility for ensuring reasonable comparability of rates within their borders. The federal mechanism leaves this state role intact, but provides support to carriers in states with average costs substantially in excess of the national average.<sup>19</sup>

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<sup>17</sup> See NOI, par. 22 (seeking comment on state and federal roles in providing universal service support).

<sup>18</sup> For example, through rate averaging, states require greater contributions to common costs from some customers than from others, creating an implicit source of support. Through cost pooling, states may require customers of one carrier to make implicit contributions to support rate reductions for customers of other carriers, similar to the Common Line Pool operated by NECA. Through state universal service funds, state may use their authority under section 254(f) and state law to raise funds for high cost areas.

<sup>19</sup> *Ninth Report and Order*, par. 46.

The federal role is therefore limited to shifting support from relatively low cost states to high cost states to ensure reasonable rate comparability. The Commission further explained its reasoning in adopting statewide averaging as follows:

Federal universal service high-cost support should be sufficient to enable reasonably comparable rates among states, while leaving states with sufficient resources to set rates for intrastate services that are reasonably comparable to rates charged for similar services within their borders.<sup>20</sup>

Recognition and reinforcement of these respective regulatory roles minimizes the need for additional support because the Commission has no need to supplant the subsidies and contributions that are now raised through state policies, including both explicit support mechanisms and implicit rate-setting methodologies.

#### **D. The Commission Should Initiate Model Changes as a High Priority**

##### **1. The Cost Model Has Serious Deficiencies**

CostQuest accurately identifies many of the mechanism deficiencies -- largely deficiencies with the current cost model -- which cause carriers serving rural states like Maine and Vermont to receive less than sufficient federal support.<sup>21</sup> Vermont/Maine agree that fixing the model should be a high priority. Some deficiencies will take substantial time and resources to remedy. Others may be fixed more quickly and be immediately applied in setting support even though a total overhaul of the model may take some additional time.

The cost proxy model method involves a very complicated computer program that models the cost of providing telephone service nationwide. The current model uses GIS type data as well as line count data to model the cost of providing service to each wire center. The model currently makes some assumptions about customer locations and the design of plant,

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<sup>20</sup> *Ninth Report and Order*, par. 7.

<sup>21</sup> *See NOI*, par. 12.

which do not come close to representing actual conditions in Maine and Vermont. However, “fixes” to that portion of the model are rather difficult and require geo-coded customer location data for the entire country.

Another flaw involves the model’s assumptions regarding distance, location, and natural barriers related to building outside plant. The current model “builds” feeder and distribution plant across natural and man-made barriers. For example, two islands next to one another are, under the current model methodology, likely to be served from the same distribution cable even though it would be physically impossible to build distribution plant in such a manner. Another clear model flaw involves the serving of houses on both sides of a railroad track. The model methodology constructs subscriber “drops” across the track in a manner which could not physically be performed. The Commission could remedy this problem by geo-coding all natural and man-made barriers to construction and developing a program which only “builds” plant along a right-of-way. In order to implement this fix, however, the Commission would have to geo-code all right-of-way information nationally. This again, is a time and data intensive task.

Finally, the model assumes that the existence of a special access or broadband line is equivalent to the existence of thousands of voice grade lines. Thus, a small town with one bank or a public library that uses some DS-3 private lines or special access circuits appears, for modeling purposes, to be a small city. This has the effect of significantly understating the costs for that area by making the area appear much more densely populated than it actually is. The Commission cannot remedy this model defect without developing a broadband cost algorithm to replace the incorrect assumption that broadband costs can be modeled by using the costs of multiple voice-grade lines.

## 2. Line Count Inaccuracies Can be Fixed Very Easily

Notwithstanding the difficulties described above, the Commission can address the deficiencies of the model as they relate to the current line counts. This one defect can be readily fixed.

When the Commission first developed the model, it used line counts for two purposes: (1) to determine the cost per line in each exchange and for each company, and (2) to determine each company's aggregate support level by multiplying the model-calculated support per line by the company's line counts. When the Commission first implemented the non-rural mechanism, it updated line counts yearly for both disbursement and modeling purposes. However, for the last seven years, it has used updated line counts only for disbursement purposes but not for the proposed modeling cost.

The Commission's failure to update the line counts for cost modeling purposes unduly disadvantages states with large line losses like Vermont and Maine. These states' cost per line is understated because the incorrectly high line counts understate the actual cost of service. When the Commission multiplies the understated support amount per line (resulting from the "costing" calculation) by the lower line counts used in the "disbursement" calculation, it compounds the problem. The line count numbers currently used in the model, which was last revised in 2002, bear little relationship to the line counts of today.

Updating line counts for both "costing" and "disbursement" purposes is not difficult although it involves a lot of number crunching and some additional data collection. Line loss calculations recently performed by Maine Commission Staff show that FairPoint has been losing lines faster than any other non-rural company in the country. This fact alone leads Vermont/Maine to believe that failing to update line counts for "costing" purposes leads directly

to insufficient support for Vermont and Maine ratepayers and companies. Fixes to this and other components of the cost model are essential to fully comply with the Tenth Circuit's Order and Section 254 of the Act. Thus, the Commission should endeavor to make all appropriate revisions to the model by the time the final rule is issued. If some of these cannot be completed by that time, at a minimum, the Commission should make the necessary corrections to the comparability percentage and cost mechanism outlined herein, and update the line count data.

### **III. THE COMMISSION SHOULD ADOPT RULES BASED ON THE VERMONT/MAINE PROPOSAL, USING "ADJUSTED MODEL-BASED COST" RATHER THAN "NET SUBSCRIBER COST"**

Vermont/Maine recommend their updated proposal as the best means of providing support for non-rural carriers that is consistent with the Court's interpretation of statutory requirements set forth by the Court in *Qwest I* and *II*.<sup>22</sup> The Vt/Me Proposal advances reasonable comparability in a manner that well targets federal support where needed. It provides sufficient support by lowering the comparability percentage and comparing rural and urban cost data. With statewide averaging, and net cost as a basis for support needs, the Fund will not grow excessively.

Vermont/Maine propose updating their earlier proposal to substitute "Adjusted Model-Based Costs" for the earlier "Net Subscriber Cost" concept.<sup>23</sup> This change clarifies and confirms that the Vt/Me Proposal is based on forward-looking cost. When Vermont/Maine proposed "Net Subscriber Cost" in 2006 as a proxy for rates, it was relatively easy to determine the level of "other carrier revenues," or revenues received from the provision of interexchange services.

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<sup>22</sup> See NOI, par. 10. Under the Vt/Me Proposal, the Commission determined each carrier's forward-looking costs of serving local customers, deducted revenues from other sources (e.g. interexchange net revenue, special access revenue, private line revenue) and divided by the number of switched lines to determine the carrier's per-line net subscriber cost. The Vt/Me Proposal based support on statewide average cost and applied a comparability standard of no more than 125% of nationwide urban rates (defined as net subscriber cost).

<sup>23</sup> *Id.*

Now, it is virtually impossible and arbitrary to identify which “package” revenues are not interexchange, or are only intrastate. In light of the widespread bundling of local/interexchange services and interstate/intrastate services into packages, Vermont/Maine can no longer advocate “Net Subscriber Cost” as a proxy for rates.

Instead, Vermont/Maine now propose using “Adjusted Model-Based Costs” to ensure that the Commission applies Fund support only for carrier plant used for supported universal services. Carriers’ loop, switching and interoffice equipment facilities are capable of providing many services in addition to local exchange service. For example, carriers use loop and interoffice investments to provide DSL and/or broadband services. They use switching investment to provide enhanced and ancillary services in addition to basic exchange service. Therefore, the Commission should remove (or “allocate away”) a portion of those facilities’ costs from the cost of supported services.

The Commission can easily remove these costs. First, it should remove a portion of loop cost revenue requirement from the model-derived loop costs. To accomplish this, the Commission should identify the number of lines which the carrier actually uses to provide broadband or DSL services. Next, it should identify the “throughput” or bandwidth of the services provided by each line. The higher the “throughput” per line sold, the larger the percentage of that particular line’s loop costs that should be removed from costs produced by the loop cost algorithm. This step has the effect of allocating a portion of the facilities’ costs associated with broadband services to those services. Moreover, to the extent that the Commission expands the universal service requirements to encompass broadband, this same mechanism could be used to adjust for the differences in the range of broadband services



offerings (*i.e.*, recognizing that a 1.5 Mbps line does not provide the same service as fiber-to-the-home).

Similarly, the Commission should remove a portion of switching cost from “modeled costs.” The number of vertical or ancillary services that are sold per line should determine the percentage amount of switching cost removed for cost modeling purposes for basic exchange service. After the Commission removes the appropriate amount of loop and switching costs, it can use the remaining “Adjusted Model-Based Costs” as a surrogate for rates.

The “Adjusted Model-Based Costs” net of support must be reasonably comparable for rural and urban areas.<sup>24</sup> The Commission must support any rural “Adjusted Model-Based Costs” that exceed urban “Adjusted Model-Based Costs” by the comparability percentage. Any support below that level will be insufficient under Section 254(b)(3).

#### **IV. THE COMMISSION SHOULD USE COSTS AS A PROXY FOR RATES TO MEASURE REASONABLE COMPARABILITY**

##### **A. Actual Local Rate Data is Too Unreliable to Use to Measure Reasonable Comparability**

Local service rates are inherently unsuited to measuring comparability for several reasons. First, they are not standardized or uniform across jurisdictions and are affected by many local variables unrelated to universal service, including individual state decisions on ratemaking practices and rate designs as well as the incumbent LEC’s investment choices. Second, no set of local rate data exists that can be used reliably, as methodological problems limit the acceptable uses of the Industry Analysis Division’s Reference Book.<sup>25</sup> Third, using actual local rates will

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<sup>24</sup> See 47 U.S.C. § 254(b)(3).

<sup>25</sup> Industry Analysis & Technology Division Wireline Competition Bureau, Federal Communications Commission, Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service, (2008) (“*Reference Book*”), at I-1. (Discussing various federal, state, county, and municipal charges that are part of customer rates).

needlessly increase the Fund's size, since local rate variables will make it appear that more support is needed to attain reasonable comparability than is justified by carriers' costs.

Local rates are difficult to compare between states because rate structures are based on many different local variables. These different rate structures, coupled with customer option plans and bundles make it virtually impossible for the Commission to identify a true "local" rate and to make reasonable rate comparisons. For example, carriers in many states offer customers local option plans that include different mixtures of fixed and variable charges. Also, most carriers market service bundles that include unlimited local, regional toll, and long-distance calling. A simple comparison of dial tone charges or local service charges would not encompass these variations and would inevitably distort the result.

Basic exchange rate levels are also greatly influenced by numerous policy variables that can effectively lower or raise local rates. For example, a state might have high residential local rates because it has chosen to increase the minimum size of a local calling area, reduce intrastate toll and access rates, reduce business rates, reduce urban rates and increase rural rates, allow carriers to recover broadband investments in basic rates, or deregulate local rates. States also differ significantly in their ratemaking practices, so a simple comparison of rates cannot normalize for the different approaches and allowed returns that are employed in the various states. Because of these policy differences, two residential customers in different states may have the same nominal local rates, yet have quite different support needs.

Moreover, any rates-based standard must reliably measure rates in places that impose Message Service and Measured Service rate designs.<sup>26</sup> In the past, the Commission has relied primarily on flat-rate data. For example, in its annual *Reference Book*, the Commission reported

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<sup>26</sup> "Message Service" denotes those plans which bill customers by the call, regardless of the length of the call, while "Measured Service" plans bill customers based on the length of the call.

on the residential rates of customers in 95 urban areas; flat-rate plans were available in all 95 areas and were used in the report.<sup>27</sup> This method is inadequate for evaluating comparability in areas using Message Service or Measured Service plans where flat-rate service may be unavailable or unpopular. Therefore, flat-rate rate data generally substantially underestimates the local exchange bill in measured service calling areas.<sup>28</sup> Even if where it does use usage data, the *Reference Book* may underestimate local usage.<sup>29</sup>

Finally, any rate comparison would also need to be adjusted to account for the differences in service offerings between states, which is an impossible task. In recent years, investment in Maine and Vermont has declined as Verizon elected to pursue more lucrative opportunities in more densely populated regions. This has left plant that is heavily depreciated, which tends to lower rates. At the same time, the range of services has lagged behind that in the more populous regions. A simple rate comparison would be inaccurate given the disparity in the range of service offerings.

#### **B. Measuring Comparability Using Local Rates May Needlessly Inflate the Fund**

The Commission should not use local rates to measure comparability because this process may needlessly and artificially inflate the Fund. It is correct that the *Qwest II* Court was troubled

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<sup>27</sup> See *Reference Book* at I-3, n.2. The *Reference Book* also reports measured rates for residential service in those urban areas where measured rate service is available. *Id.* at T. 1.3. However, those data have not been used in analyzing historical trends or in universal service calculations that utilize values for the national “representative monthly charge” and the “standard deviation” of those representative monthly charges. *Id.* at T.1.4, T. 1.13.

<sup>28</sup> Verizon-Vermont submitted billing data for August- September 2005 to the VtPSB. The Flat-Rate Dial Tone rate in Vermont is \$13.15. For every dollar paid by Verizon-Vermont customers under that charge, they pay more than another 50 cents in the form of local usage charges. A substantial minority of Vermont customers pays a “capped” local exchange charge (including local usage, but excluding SLCs, surcharges, and taxes) of \$39.40 per month.

<sup>29</sup> The Commission has made efforts to measure the effects of Measured Service rates, but it has not adequately updated its methodology. The *Reference Book* translates measured service rates into equivalent flat rates for comparison purposes. It assumes that residential customers make 500 minutes per month of outgoing calls at one measured rate. If flat-rate service is unavailable, the FCC uses the measured/message service rate, along with the charges associated with placing 100 five-minute, same-zone, business-day calls. See *Reference Book* at I-2, n.3; T. 1.2. However, this assumption has not been verified as realistic under modern usage patterns.

by the wide divergence in local rate data.<sup>30</sup> After reviewing the actual rate data in the record and comparing the Commission's comparability benchmark to the nationwide urban average, the Court "fail[ed] to see how they could be deemed reasonably comparable."<sup>31</sup> The Court noted that "rural rates falling just below the comparability benchmark may exceed the lowest urban rates by over 100%."<sup>32</sup> In other words, the Court tested the Commission's support system, in part, by comparing the lowest urban rates against the support benchmark. (Low-Rate Comparability Test).

The Court raised specific concerns about using a measure other than rates in making urban/rural comparisons. The Commission can address these concerns by thoroughly explaining why it is impossible to use simple local rate comparisons, and developing an evidentiary record showing that costs are a more accurate indicia of support needs. A rates-based comparability standard would force the Commission to provide universal service funding to address rate differences that arise from cost of service differences but also state policy decisions that have nothing to do with need. For example, states may create large local calling areas with higher local rates, but they have eliminated toll charges for short and medium haul calls. Basing support needs on rates could have the unintended effect of encouraging further rate deaveraging, thereby leading to greater support. Such a trend will needlessly inflate the Fund, without ensuring that Congress's primary rate comparability objectives are actually met.

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<sup>30</sup> *Qwest II*, 398 F.3d at 1237.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

**C. The Commission Should Compare Cost in Rural and Urban Areas as a Proxy for Rates**

To avoid all these problems, the Commission should affirm its prior findings, made consistently in multiple orders, that costs<sup>33</sup> are a more reliable basis than rates for determining universal service support.<sup>34</sup> The Commission has previously explained that the only meaningful way to account for rate differences among states is to adopt cost as a proxy for rates under Section 254:

[W]e must consider cost differences in determining which states need federal support to achieve rural rates that are comparable to urban rates...[T]he Joint Board and the Commission always have looked at cost differences, not rate differences, in determining high-cost support. Because the underlying purpose of rates is to recover the cost of providing service, comparing costs provides a more accurate and consistent measure of what rate differences would be in any given state, given identical state rate policies.<sup>35</sup>

Additionally, because states retain jurisdiction over local rates, the Commission cannot control development of rates, or rate design policy, so as to ensure meaningful rate comparisons.

Neither *Qwest I* nor *Qwest II* suggests abandonment of cost-based support. In *Qwest I*, the Court did not reject the high-cost mechanism because it was based on cost.<sup>36</sup> To the contrary, the Court determined that the Commission *could* adopt a cost-based USF mechanism as long as it tied the mechanism to the rate-related statutory standard and made empirical findings based on rural and urban cost data in the record to demonstrate that the mechanism actually fulfilled Congress's objectives.<sup>37</sup> In fact, if the Commission's cost-based support system actually produced reasonably comparable urban and rural rates, the Court would likely have upheld the

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<sup>33</sup> Vermont/Maine recommend that the Commission use "Adjusted Model-Based Costs" to determine carriers' costs. See Section III(B), *infra*.

<sup>34</sup> *In the Matter of Federal State Joint Board on Universal Service*, Order on Remand, Further Notice of Proposed Rulemaking and Memorandum Opinion and Order, 18 FCC Rcd. 22,559 par. 23 (2003) ("*First Remand Order*"). See also, NOI at par. 23.

<sup>35</sup> *First Remand Order*, par. 23.

<sup>36</sup> See *Qwest I*, 258 F.3d at 1202.

<sup>37</sup> See *Qwest II*, 398 F.3d at 1237.

mechanism.<sup>38</sup> Therefore, the Commission *may* use the current cost-based mechanism to achieve the Act's principles as long as it modifies the mechanism, as the Court directed, and shows that the program is likely to meet the statutory goals.<sup>39</sup> As long as the Commission provides sufficient support so that costs are comparable, then rate comparability immediately follows.

**V. THE COMMISSION SHOULD REDEFINE “SUFFICIENT” TO ENSURE THAT SECTION 254(b) PRINCIPLES ARE MET THROUGH ALL UNIVERSAL SERVICE PROGRAMS**

**A. The Commission Should Redefine “Sufficient”**

The FCC should redefine “sufficient” support, for purposes of Section 254(e), as:

...enough support, through all the universal service programs funded under Section 254 mechanisms, to ensure that the support-related principles set forth in Section 254(b) are preserved and advanced.

This definition will explicitly ensure that the Commission addresses all statutory principles and recognizes that some programs advance several principles, even if one is primary.<sup>40</sup> The non-rural support mechanism primarily advances the goal of achieving reasonably comparable urban and rural rates and services, and this principle should be given most weight in designing the mechanism. High-cost programs are not the best means to address affordability. Other USF programs are specifically designed to accomplish this purpose.

**B. The Commission Does not Need to Satisfy All Principles Through the High-Cost Program**

The Commission does not need to balance or satisfy all seven Section 254(b)(3) principles in defining “sufficient.” While the Court mentioned that the statute’s principles might conflict, it also complained in the same paragraph about the “limited record” before it.<sup>41</sup> In fact,

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<sup>38</sup> See *Qwest I*, 258 F.3d at 1202.

<sup>39</sup> *Id.* at 1202-03.

<sup>40</sup> See NOI, par. 17.

<sup>41</sup> *Qwest II*, 398 F.3d at 1234.

the Court had before it little or no information about other major federal high-cost support programs or the Lifeline and Link-Up programs. The Commission should explain all of its universal service programs, including their purposes, sizes, effects, and relationships to the statutory principles, and make findings describing how it addresses each Section 254(b) principle through one or more of its support programs. It should also show how those programs, taken together, provide sufficient support. Providing this additional explanation as part of the evidentiary record will permit a reviewing Court to properly assess “the total level of federal support for universal service to ensure ‘sufficiency.’”<sup>42</sup>

### **C. The High-Cost Program Is Not the Best Means to Address Affordability**

In its analysis of an affordable rate definition,<sup>43</sup> the Commission should find that high-cost support indirectly advances affordability and does not conflict with it. High-cost support programs cannot directly address affordability principles and are not the best or most efficient mechanisms to do so. Section 254 does not link “affordable” and “reasonably comparable.” Even if rates are affordable, the Fund must be increased to ensure rates are reasonably comparable.

The principle of “affordable rates” is different from “reasonably comparable rates.” The reasonably comparability principle restricts the allowable range of rates throughout urban and rural parts of the country without regard to income levels of individuals or groups of individuals. Although a program aimed at making rates reasonably comparable will also help make rates affordable, the two principles are largely independent.

For several reasons, high-cost programs are not the most effective tools to address affordability. First, high-cost programs do not always produce rate decreases. The statute

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<sup>42</sup> *Qwest I*, 258 F.3d at 1204. The Court directed the FCC on remand “to explain further its complete plan for supporting universal service.” *Id.* at 1205.

<sup>43</sup> See NOI, par. 18.

requires carriers to “use [high-cost] support for the provision, maintenance, and upgrading of facilities and services for which the support is intended.”<sup>44</sup> Because high-cost support can be used to upgrade, construct, or maintain facilities, it does not necessarily reduce end-user rates. Further complicating the issue, many states have eliminated or greatly modified traditional “rate of return” regulation of local companies. In these states, an increase in high-cost support may not affect consumer rates at all.

Second, even in areas where increased support actually lowers rates, the benefits of that support flow equally to rich and poor customers. In contrast, the Lifeline and Link-Up programs have individual eligibility criteria and are therefore efficient methods to address individual affordability problems.<sup>45</sup>

**D. The Commission’s Contribution System Must Ensure the Fund is Sufficient, but not Excessive**

The Commission should consider the burden on universal service contributors to ensure that the Fund is not excessive in size.<sup>46</sup> The Tenth Circuit linked the idea that support should only be as large as necessary to the principle of affordability.<sup>47</sup> In fact, the size of the Fund has been an issue for some time now. In its *First Remand Order*, the Commission determined that the non-rural high-cost fund must be “only as large as necessary.”<sup>48</sup> The Tenth Circuit, however,

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<sup>44</sup> 47 U.S.C. § 254(e).

<sup>45</sup> See *In the Matter of Lifeline and Link-Up*, WC Docket No. 03-109, Report and Order and Further Notice of Proposed Rulemaking, 19 FCC Rcd. 8302, 8305, 8312 (2004) (citing the statutory goals of the Lifeline/Link-Up program as “maintaining affordability and access of low-income consumers to supported services, while ensuring that support is used for its intended purpose”); see also *In the Matter of Access Charge Reform; Price Cap Performance Review for LECs; Low-Volume Long Distance Users; Federal-State Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Order on Remand, 18 FCC Rcd. 14,976, 14,982 (2003) (“In order to preserve affordability for low-income consumers, the Commission [ ] increased universal service support under the Lifeline mechanism”).

<sup>46</sup> See NOI, par. 20.

<sup>47</sup> *Id.*

<sup>48</sup> *First Remand Order*, par. 4.



held that the Commission had failed to appropriately consider the range of principles in Section 254(b).<sup>49</sup>

Although the Tenth Circuit expressed concern about gratuitous subsidies, that observation was a criticism of *excessive* support, not an argument against *sufficient* support. The Tenth Circuit stopped far short of encouraging the Commission to find that the sufficiency requirement conflicted with the affordability principle. It did not suggest that the requirement to provide sufficient support is balanced by notions of affordability. Section 254(d)-(e) obligates the Commission to provide sufficient support, and no concept of “excessive subsidization” can undermine that duty.

Vermont/Maine cannot recommend an overall cap on high-cost funding. Under the sufficiency requirements of 254(b)(3), the Commission must change the share of the entire Fund devoted to high-cost support or increase the overall size of the Fund. It has been suggested that many areas of government must operate within a budget and that high-cost funding should do the same. That position ignores the Section 152(b)(3) sufficiency requirement and *Qwest I* and *II*. At the very least, the total contribution amount must have some factual support based on cost analysis showing that it is sufficient to fund the reformed system.

## **VI. THE QWEST AND EMBARQ PROPOSALS ARE TOO COSTLY**

As Qwest acknowledges, targeting support based on highest cost wire centers could inflate the Fund size by as much as \$1.2 billion,<sup>50</sup> rendering it unsustainable. However, Qwest’s and Embarq’s<sup>51</sup> plans to avoid this result by providing support only to some high cost carriers is inconsistent with the Act’s sufficiency requirement.

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<sup>49</sup> *Qwest II*, 398 F.3d at 1234.

<sup>50</sup> See NOI, par. 9.

<sup>51</sup> See NOI, par. 11.

The *Qwest II* Court remanded this case because the Commission had not shown that its mechanism will provide sufficient support and advance Section 254(b) principles. If the Commission adopts Qwest's or Embarq's strategy for keeping the Fund size small, and limits funding to high cost wire centers or to an arbitrary amount, it will repeat its past errors and again create an insufficient Fund. Essentially, it will assume the financial burden of achieving all of Section 254's requirements solely through the Fund, without any help from states. Such an approach is not consistent with the practice to date under which states are responsible for addressing cost disparities within the state, and the Commission focuses the Fund on reducing cost differences between states.

Moreover, the Qwest approach is not sustainable in the long-run. As the Fund continues to grow, the Commission will be faced with arbitrarily limiting its size through a cap or some other means. At that point, the Commission will not have any assurance that support will continue to be sufficient, as the Court has required.

The Embarq Broadband and Carrier of Last Resort Support Solution<sup>52</sup> ("BCS Solution") has many positive attributes and, if adequately funded, would make substantial progress towards fulfilling the Joint Board's November 2007 recommendations. Vermont/Maine also support Embarq's goal of providing an integrated solution to the *Qwest II* remand, broadband deployment, and intercarrier compensation.

However, the BCS Solution's funding plan would arbitrarily set support at the total of the various existing high cost support mechanisms of \$994,000,000.<sup>53</sup> Embarq has not shown that the Fund's size under its proposal would be sufficient to meet the *Qwest II* requirements, let

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<sup>52</sup> *In the Matter of High Cost Universal Service Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, A Plan to Promote Broadband Deployment and Reform High-Cost Support Without Increasing Overall USF Levels: The Broadband and Carrier-of-Last-Resort Support (BCS) Solution (Sept. 10, 2008).

<sup>53</sup> See BCS Solution, p. 21.

alone the needs associated with broadband deployment and intercarrier compensation reform. The desire to promote the availability of broadband service is laudable but, by Embarq's own admission, is far less than the price tag of about \$12 billion cited by NECA to build broadband service to 5.9 million households.<sup>54</sup> Embarq has not even provided a price estimate to support a commitment to provide broadband at a speed of 1.5 Mbps within the next five years.<sup>55</sup> It is also not clear that use of the 1.5 Mbps speed is appropriate since it is not comparable with broadband service that will be available in most urban areas. Thus, it may be inconsistent with Section 254's requirement that urban and rural rates and services be reasonably comparable.

The Commission must provide sufficient support so that the services provided in rural areas are comparable in availability, technical capability and price to those services provided in urban areas. Now is the time for the Commission to analyze whether to include broadband as a "supported service." If it does so, then USF support for broadband must meet the sufficiency requirement. The Commission should work with state regulatory commissions, the Joint Board and industry to develop a broadband comparability standard and to perform the necessary analysis to develop a funding level which meets the comparability standards of Section 254(b)(3).

## **VII. CONCLUSION**

The Commission should move forward quickly to address the *Qwest II* remand. It should adopt the updated Vt/Me Proposal as the best means of providing support to non-rural carriers that is consistent with *Qwest II*. The Vt/Me Proposal provides sufficient support by lowering the comparability percentage and comparing rural and urban cost data. By maintaining statewide averaging and determining carriers' support needs based on their net costs, the Vt/Me Proposal

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<sup>54</sup> *Id.*, p. 33.

<sup>55</sup> *Id.*, pp. 31-32.

ensures that the Fund is not excessive in size. The Commission should compare rural and urban costs (Adjusted Model-Based Costs) as a proxy for rates when determining whether carriers' rates are reasonably comparable.

The Commission should also adopt the following definitions of Section 254 terms:

Rates are reasonably comparable when rural rates, on a statewide average basis, are [no greater than 125%]<sup>56</sup> over urban rates.

The Universal Service Fund is sufficient if it provides enough support, through all the universal service programs funded under Section 254 mechanisms, to ensure that the support-related principles set forth in Section 254(b) are preserved and advanced.

The Commission should coordinate related initiatives, including encouraging broadband deployment, and updating its cost model, as high priorities, and use the Joint Board to expedite matters. The Commission's work responding to the Court will be incomplete without revising its model so that it generates reasonably accurate cost. The Commission should seek to adopt model revisions by the time it adopts its new rules in response to the *Qwest II* remand.

Respectfully submitted this 8<sup>th</sup> day of May, 2009.

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<sup>56</sup> Vermont/Maine recommend that the Commission set a benchmark between 115% and 125% to achieve reasonable comparability. They do not yet have a specific numerical recommendation.